Service Date: July 18, 1994

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER Of the Investigation of § 712 Standards of the Energy Policy Act of 1992.	)))	UTILITY DIVISION DOCKET NO. 93.3.10 ORDER NO. 5701b

FINAL ORDER

BACKGROUND

1. On October 24, 1992 President Bush signed the Energy Policy Act of 1992 (EPAct). Section 712 of the EPAct amends § 111(d) of the Public Utility Regulatory Policies Act of 1978 (PURPA) and requires the Montana Public Service Commission (Commission) to consider and determine whether it is appropriate to implement certain standards for jurisdictional electric utilities that may purchase long-term wholesale power to meet demand. 16 U.S.C.A. §2621(10)(E). The EPAct directs the Commission to evaluate the following:

> (i) the potential for increases or decreases in the costs of capital for [electric] utilities, and any resulting increases or decreases in the retail rates paid by electric consumers, that may result from purchases of long-term wholesale power supplies in lieu of the construction of new generation facilities by [electric] utilities;
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> (ii) whether the use by exempt wholesale generators (as defined in section 32 of the Public Utility Holding Company Act of 1935) of capital structures which employ proportionally greater amounts of debt than the capital structures of [electric] utilities threatens reliability or provides an unfair advantage for exempt wholesale generators over [electric] utilities;

> (iii) whether to implement procedures for the advance approval or disapproval of the purchase of a particular long-term wholesale power supply; and
>
> (iv) whether to require as a condition for the approval of the purchase of power that there be reasonable assurances of fuel supply adequacy.

Id. §2621(d)(10).

2. For shorthand purposes the Commission will refer to these elements, respectively, as "cost of capital," "capital structure," "preapproval," and "fuel supply."

3. On March 25, 1993 the Commission issued Order No. 5701, establishing this Docket and providing an opportunity to intervene. The following entities intervened and are parties to this Docket: Montana Consumer Counsel (MCC), Montana Power Company (MPC), PacificCorp (Pacific), Large Customer Group (LCG), Champion International Corporation (Champion), Department of Natural Resources and Conservation, Paladin Associates, Montana-Dakota Utilities (MDU), Continental Hydro Corp., Billings Generation, Inc., Colstrip Energy Limited Partnership, and Enron Corporation (Enron).

4. On May 25, 1993 the Commission issued Procedural Order No. 5701a, giving parties an opportunity for discovery and simultaneous direct and answer testimony. The following parties filed direct testimony: MPC, Pacific, MDU, MCC, LCG/Champion and Enron. MPC and LCG/Champion filed answer testimony. A hearing date was set for September 14, 1993.[1] Due to party scheduling

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[1] Procedure in this Docket follows the requirements set forth at 16 U.S.C.A. §2621(b)(1) and (2); see 16 U.S.C.A. §2621(d)(10)(D).

conflicts the hearing date was changed twice and finally vacated. The parties agreed to waive their right to a hearing and stipulated that the evidentiary record in this Docket consists of prefiled testimony, data responses and other evidence of which the Commission may legally take administrative notice. No party asked to file a brief, and the matter has been submitted for decision since November 1, 1993.

SUMMARY OF POSITIONS-DIRECT TESTIMONY

MPC

Cost of Capital

5. MPC concludes that a "significant potential exists" that the cost of capital will increase for utilities that purchase long-term wholesale power to meet supply obligations. MPC explains that purchased power is viewed by the rating agencies as having "debt-like" or "debt equivalent" qualities, because purchased power payments are fixed obligations, similar to obligations incurred in utility construction projects. MPC argues that traditional regulation does not compensate investors for the debt equivalent risk inherent in purchased power.

6. MPC uses Standard and Poor's (S&P) analysis to determine the debt-equivalent component of its current purchased power obligations. Using this analysis MPC determines the present value of capacity payments required by its purchased power contracts. This present value figure is then multiplied by 20

percent to get S&P's debt equivalent.[2] To illustrate this analysis, MPC calculates a present value of $92 million (using a 10 percent discount rate) for its capacity payment obligations at the end of 1992. Multiplying that figure by 20 percent results in $18 million of debt equivalent. MPC adds to this a $10 million debt equivalent for energy purchase obligations, giving a "total purchased power debt equivalent of $28 million" at the end of 1992. (The debt equivalent changes from year to year as purchased power contract obligations change.) Interest must be imputed on the debt equivalent so, at 10 percent, a $28 million debt equivalent yields a $2.8 million interest expense, requiring $8.4 million in revenues over the amount necessary to cover the direct purchased power costs. ($2.8 x an interest coverage ratio of 3 = $8.4).

7. MPC contends that traditional regulation does not allow for revenues sufficient to cover imputed interest on the debt equivalent of purchased power. Traditional utility investment is financed by debt and equity, with the equity providing an "important buffer of protection for bondholders." Traditional regulation treats purchased power as an expense, allowing at best dollar-for-dollar reimbursement. Thus, MPC continues, since

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[2] MPC does not explain how S&P determines 20 percent as a risk factor. It does say, however, that "regulatory treatment of purchased power is a factor in determining the 20% risk factor." It argues that a purchase power tracker or a preapproval mechanism would help reduce the risk factor and the debt equivalent. It also says that anything that shifts risk from the utility to the power seller will reduce the debt equivalent risk factor.

traditional regulation does not recognize imputed interest on the debt equivalent of purchased power, the equity return on rate base "must perform the double duty of providing coverage for traditional utility debt, as well as the purchased power obligation." The long-term consequence, according to MPC, is that since overall debt-coverage is diluted, investors perceive greater risk, resulting in greater cost of capital and, ultimately, higher retail rates.

8. MPC recommends that the Commission take one, or a combination of several steps to address the risks of purchased power: First, utilities could be authorized to recover an amount above the cost of purchased power; second, for ratemaking purposes the equity component of the capital structure could be increased; third, actual capital structure could include additional equity; fourth, an incremental return on equity above the otherwise authorized return could be approved. MPC acknowledges that these steps would increase short-term rates but contends that because the result would be a more financially sound utility long-term rates would decrease.

9. MPC does not make a specific recommendation for addressing the risk of purchased power. Rather, it suggests that a roundtable discussion "may be the best approach to reaching a consensus on the option selected." MPC maintains that addressing the current risks of purchased power in some form is important to removing an impediment to utility acquisition of least cost resources.

Capital Structure

10. MPC states that it is difficult to gauge the effect on reliability of the highly leveraged capital structures of exempt wholesale generators (EWG)[3]. Lenders impose strict requirements on highly leveraged EWG financings and this enhances reliability. MPC expresses apprehension, however, that after the lenders have been paid off, reliability may become an issue if plant owners lose the economic incentive to adequately maintain the plants. MPC claims that traditional utilities face increased reliability risk from EWGs because EWG's long-term reliability is unknown.

11. MPC concludes that the highly leveraged capital structures of EWGs do not give them an unfair financial advantage over utilities, "if the debt equivalent of purchased power is properly reflected in the regulatory ratemaking and cost structure." If the debt equivalent of purchased power is not reflected in utility costs then "EWGs do have an unfair financial advantage in attracting investors."

12. MPC also notes a general concern over EWGs' ability to deliver the power as promised. Tight credit markets and the general credit-worthiness of the developers can affect whether a plant is sited, built and performs as promised. These are concerns MPC considers in its bidding and least cost planning processes.

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[3] At §711 of the EPA Congress amended the Public Utility Holding Company Act of 1935 by creating EWGs. EWGs are defined at 15 U.S.C.A. 79z-5a.

Preapproval

13. MPC supports preapproval of purchased power, and it encourages the Commission to adopt a preapproval policy. Citing S&P, MPC lists contract preapproval as an important factor in reducing the risk of purchased power. When a contract is executed, a need analysis and least cost planning analysis has been completed; therefore, there is sufficient information to determine whether the contract is prudent and should be included in future rates. MPC argues that preapproval would cut the debt equivalent risk factor in half, thus lowering utility risk and customer rates. MPC also argues that the Commission should preapprove "sales and exchanges of surplus capacity and/or energy."

14. MPC claims preapproval would give it "insight into the various terms and conditions that the Commission considers important." It also contends that preapproval will "increase the likelihood that correct resource decisions are being made." MPC encourages preapproval, despite the Commission's traditional opposition to it. In addition, MPC encourages commitment to "the kind of decision rules set forth in the [Integrated Least Cost Planning (ILCP)] rules and the recently passed ILCP statute."

Fuel Supply

15. If the Commission were to preapprove long-term purchased power contracts, MPC urges that such preapproval be conditioned on fuel supply adequacy. MPC states that fuel supply adequacy is currently evaluated in the least cost planning process and is also carefully evaluated by lenders financing power projects.

Pacific

Cost of Capital

16. Pacific concurs with MPC that bond rating agencies may impute debt equivalents to a utility with purchased power contracts. When assessing debt equivalents the rating agencies consider market risk, operating risk, regulatory risk and financial risk. Of these, Pacific states that only financial risk can be reasonably quantified. And, it states that these risk factors can vary widely by utility and by particular power purchase. Consequently, Pacific argues that purchased power risk should be assessed for each company within a general rate case. It argues that the Commission should not adopt generic standards to apply to changes in the cost of capital as a result of purchased power. If it is determined in a rate case that Pacific's purchased power decisions have affected its risk rating, then Pacific's capital structure or allowed return can be adjusted to compensate.

Capital Structure

17. Pacific does not support generic standards for evaluating the reliability risk of highly leveraged EWG capital structures. Pacific believes that the effect of EWG purchases on reliability should be dealt with by utility management and reviewed by the Commission in a rate case. Small purchases of EWG power are not "particularly troubling" to Pacific; however, "a strategy of principally relying" on EWG power would cause reliability concerns.

18. Pacific does not support standards on whether highly leveraged capital structures provides EWGs with an unfair advantage over utilities. An analysis of the effects of EWG capital structures on utilities should be on a company-specific basis.

Preapproval

19. Pacific opposes Commission preapproval of long-term power purchases. Power purchases should be reviewed in rate cases, and power purchase costs should be reviewed for inclusion in rates on the basis of whether they are prudent. Pacific argues that preapproval "would inappropriately shift managerial responsibility to the Commission," and "would not further the stated purposes of PURPA."

Fuel Supply

20. Pacific opposes Commission imposed standards on fuel supply adequacy as a condition for approving purchased power contracts. (This follows from Pacific's opposition to preapproval generally.) Pacific claims that such standards would limit its flexibility in negotiating supply contracts, and it argues that the Commission has traditional ratemaking remedies if inadequate fuel supplies result in energy costs that the Commission deems imprudent.

MDU

Cost of Capital

21. MDU argues that purchased power has the potential for both increasing and decreasing risk. Like MPC and Pacific, MDU notes the debt equivalent features of purchased power that may result in lower bond ratings and higher capital costs. MDU notes in addition that purchased power may lower risk by 1) allowing a utility to buy power when needed, reducing excess capacity costs, 2) reducing up front cash requirements associated with constructing a generating facility, 3) utilizing competitive bidding, and 4) diversifying power purchases among several suppliers, reducing the risk of relying on fewer large generating sources.

22. MDU recommends that a "flexible approach" to traditional ratemaking will best minimize the increased risk of purchased power. As options, MDU suggests 1) allowing a return on purchased power contracts, 2) allowing an increased return on rate

base to compensate for increased risk, or 3) allowing capacity charges to be recovered through the fuel adjustment clause. MDU does not indicate whether the Commission should consider generic standards, or adopt a "flexible approach" on a case specific basis.

Capital Structure

23. MDU states that a highly leveraged EWG capital structure "carries a higher risk along with the cost advantage." High leverage means less financial stake in a power project by its owners. MDU agrees with MPC that EWG owners may cut and run once debt obligations are met. This creates a reliability and financial risk to the utility. MDU stresses that the Commission should recognize these risks in the regulatory process, and should consider "required minimum equity ratio[s] for EWGs in order to attain a level playing field for utilities and EWGs."

Preapproval/Fuel Supply

24. MDU favors Commission preapproval of large long-term power purchase agreements. MDU states that "contract pre-approval, particularly as part of the IRP process, is becoming critical." It notes that a preapproval process must recognize that MDU is a multijurisdictional utility. MDU urges that fuel supply adequacy be a condition of contract preapproval.

MCC

25. MCC begins by noting that Section 712 of the EPAct amends section 111 of PURPA, and therefore the purposes of PURPA should control when determining whether to adopt generic standards. PURPA purposes are 1) conservation of energy supplied by electric utilities, 2) greatest efficiency of use of facilities and resources by electric utilities, and 3) equitable rates to electric customers. MCC contends that the EPAct does not require the Commission to adopt generic standards and states that it would be preferable to treat cost of capital implications of purchased power on a case-by-case basis.

26. While MCC does not favor generic standards, he does recommend emphasizing the general principle that power purchases should be encouraged when they represent the least cost resource, but they should be discouraged when they result in enlarged risks and capital costs to ratepayers. As an example, MCC points to Commission Docket No. 90.8.51, in which MPC's avoided cost price for a power purchase from Billings Generation, Inc. was at issue. MCC argued in that case that ratepayers were double-charged because the avoided cost price paid to BGI "included MPC's full capital cost risk premium, but BGI did not assume any of the risks of regulatory cost disallowance." Instead, those risks were shifted to ratepayers because of the Commission's promise that no regulatory disallowance would be made for BGI costs. Thus, MCC contends that the ratepayers paid BGI (through the avoided cost price) to take the regulatory risk, but the risk did

not shift to BGI due to the Commission's guarantee of cost recovery.

27. The lesson of the BGI case, according to MCC, is that utilities should not be authorized to pay "wholesale power rates that exceed the lowest cost alternative." Utilities should be at risk of losing money for failing to accurately calculate avoided costs, just as other businesses, not their customers, are at risk for making mistakes.

28. Specifically addressing the questions raised in this Docket, MCC 1) recommends that any effects on a utility's cost of capital from purchased power be considered on a case-specific basis, 2) submits that highly leveraged capital structures of some wholesale generators do not create a fairness or reliability problem if payments to the generators reflect actual avoided costs, 3) opposes preapproval of purchased power because it "could encourage inefficient resource choices ... and be unfair to consumers[,]" and 4) contends fuel supply adequacy should be the responsibility of utility management.

LCG/Champion

Cost of Capital

29. LCG/Champion argue that it is unnecessary to adopt standards on changes in the cost of capital that may result from long-term power purchases. They argue that the current rate case process can address any higher capital costs that result from power purchases. If power purchases cause higher capital costs a

utility can file a rate case in which all costs will be scrutinized to see if higher rates are necessary. Rules on the capital cost effects of power purchases could have the effect of "restricting the utilities from making least-cost decisions."

Capital Structure

30. LCG/Champion question the assumption that EWGs have greater long-term debt and lower cost of capital than utilities. Over the lifetime of an EWG project, LCG/Champion assert that EWG debt may actually be lower than that of a utility.

31. Further, LCG/Champion claim there "is not a clear relationship" between level of debt and the reliability of an EWG. First, most Independent Power Producers have good reliability records; second, utilities have established reliability standards that they can impose on independent producers; and third, the Commission can impose the used and useful standard on power purchases, so that if the power producer is not reliable, costs of the power purchase can be denied.

32. Finally, LCG/Champion argue that EWG capital structures do not necessarily give EWGs an unfair advantage over utilities. Different capital structures for EWGs and utilities may be appropriate given the different nature of the businesses. To the extent that different capital structures make it cheaper for a utility to buy than build, this is a benefit to ratepayers. LCG/Champion question whether "unfair advantage" is an appropri-

ate description of a situation where lower capital costs leads to increased competition, lower power costs and lower rates.

Preapproval

33. LCG/Champion oppose preapproval of power purchase agreements because 1) it would guarantee cost recovery, 2) it would undermine the used and useful principle whereby utility expense or investment should only be allowed in rates following a determination of used and useful and prudence in a general rate case, 3) it would alter regulatory principles by shifting risk from utilities to ratepayers, and 4) it would improperly place the Commission in a utility management role. Specifically with respect to least cost planning, LCG/Champion assert that preapproval would violate ARM 38.5.2001(3) (least cost planning guidelines) which states that "[t]hese guidelines do not change the fundamental rate-making relationship between the utilities and the Commission." LCG/Champion argue this pronouncement would be undermined by a decision to preapprove which "would have the effect of fundamentally changing the regulatory compact with respect to wholesale power purchases."

Fuel Supply

34. LCG/Champion oppose a rule that would require fuel supply adequacy prior to approval of a purchased power agreement. They argue that fuel supply adequacy is not unique to purchased power and should be considered as part of a utility's integrated

resource planning process. They also maintain that a utility's obligation to provide adequate service does not change when a utility purchases power. A utility's obligation to ensure adequate fuel supply remains the same, whether it is purchasing or generating power. LCG/Champion recommend that the Commission not interject itself into the development of power purchase agreements.

Enron

Cost of Capital

35. Enron believes that purchased power reduces the cost of capital for utilities. Purchased power is not risk free, but it is less risky than self-generation because it shifts risk of ownership and operation to the seller. Enron acknowledges that rating agencies are taking a closer look at purchased power, but notes that purchased power is only one of many things that determines a utility rating. Enron concludes that "the investment community realizes that power purchases are less risky than the construction of new power plants." Further, Enron opines that purchased power has "decreased the cost of capital for many utilities." The result, according to Enron, is that purchased power "will almost by definition reduce the retail rates of a purchasing utility compared to other power supply options."

Capital Structure

36. Enron concurs with LCG/Champion that, over the life of the project, EWGs are no more highly leveraged than utility plants. Enron states flatly that, whatever the differences in capitalization between EWGs and utility plants, there is "no evidence that the capitalization of EWGs has any impact on the reliability of power supply or represents any sort of 'unfair advantage' over utilities." Enron submits the evidence indicates that cogeneration plants have been at least as reliable as utility-owned plants, and claims there is no reason to think EWGs will be less reliable than cogenerators.

Preapproval

37. Enron supports preapproval of power purchase contracts on the grounds that it "removes a great degree of regulatory uncertainty and makes it easier and less expensive for non-utility generators to finance their generating facilities." This equates in the long-run to lower priced purchased power. Enron suggests preapproval proceedings should be focused and expeditious.

Fuel Supply

38. Enron opposes imposing fuel supply requirements on EWGs that are not also imposed on utilities. Enron claims there is no historical evidence that fuel supply has been more problematic for non-utility generators than for utilities. Enron concludes

that there is no reason to impose fuel supply adequacy standards on EWGs as a condition for approval of a purchase agreement.

Summary of Positions-Answer Testimony

MPC

Cost of Capital

39. MPC reemphasizes that both utility-generated power and purchased power have risks, but purchased power risks are not reflected in the regulatory process. MPC contends that purchased power may sometimes be the least cost resource, but if purchased power is to compete with utility-constructed resources the risks of purchased power must be recognized in rates. To properly reflect the risks of purchased power in rates MPC expresses a preference for the third alternative described in its direct testimony (see p. 5, paragraph 8, supra): authorization to adjust its actual capital structure to include additional equity, "to provide coverage or cushion for fixed purchased power obligations." MPC seeks Commission approval of this adjustment so that increased equity will be reflected in rates.

Preapproval

40. MPC strongly disagrees that preapproval "leads to inefficient use of utility facilities and resources[.]" MPC claims that preapproval will avoid inappropriate resource selection and possible financial loss to utilities; and it stresses

that the financial integrity of utilities is important to customers and society.

41. Regarding MCC's comments on the BGI Docket (No. 90.8.51), MPC responds that it does assume the risks of purchased power, without compensation. Regulatory risk should be shifted to power sellers through regulatory out language, but preapproval should also occur. Absent preapproval, regulatory out language creates financing burdens on EWGs that will cause EWG costs to rise. MPC does not agree that preapproval constitutes micro-management by the Commission. MPC notes that resource plans are reviewed by the Commission and resource acquisitions are reviewed in the rate case process.

Capital Structure

42. MPC agrees with MCC that the highly leveraged capital structure of most EWGs "is due to substantial shielding from business, market and regulatory risk[.]" MPC claims that in most contracts EWGs have only operating and construction risks.

43. Finally, MPC states that its recommendations in this Docket are consistent with the Commission's least cost planning guidelines (ARM 38.5.2001-2012): "They suggest ways to reduce and manage risks of resource choices to shareholders, ratepayers and society."

LCG/Champion

Cost of Capital

44. LCG/Champion challenge MPC's and MDU's recommendations for compensating utilities for the risks of purchased power. LCG/Champion argue that these recommendations are based on faulty assumptions: first, that the regulatory playing field is biased against purchased power and needs to be levelized, and second, that traditional regulation does not already compensate adequately for the risks of purchased power.

45. LCG/Champion argue that MPC and MDU are incorrect in their presumption that "buying is more risky than building." There are risks associated with purchased power, but those risks are not necessarily greater than the risks of utility construction, and purchased power risk can be substantially mitigated with properly structured power purchase agreements. Further, LCG/Champion contend that traditional cost of service regulation adequately compensates for purchased power risk through the normal evaluation of cost of equity and financial integrity. A general rate case, they continue, "is the proper forum for evaluating the overall revenue needs of the utility, including the return required to compensate investors" for the risks of purchased power.

46. LCG/Champion also criticize MPC's and MDU's proposal that purchased power risk be reduced by preapproval of power purchase contracts or by creating "tracker" mechanisms for purchased power costs. They describe the conditions that support

"trackers" -- when a cost item is volatile, material and beyond a utility's control -- and conclude that none of these conditions characterize purchased power costs. LCG/Champion contend that if either a "tracker" or preapproval were implemented the Commission would have to lower the return on equity of the affected utilities to compensate for lower risks to investors. LCG/Champion conclude that the recommendations of MPC and MDU to address the impacts of purchased power on cost of capital should not be adopted. Evaluation of those impacts should be on a case-by-case basis using traditional regulatory analysis.

Capital Structure

47. LCG/Champion disagree with MDU's recommendation that the Commission require a minimum equity ratio for EWGs. LCG/Champion call the recommendation unnecessary because "there is no evidence that EWGs have a higher debt ratio than utilities over the life-cycle of a particular project or that there is any connection whatsoever between the higher debt leverage and EWG reliability." Further, requiring a minimum equity ratio would not benefit ratepayers because it would eliminate projects that do not meet the minimum equity ratio, but considering all other factors might be more cost effective than projects that do meet the equity ratio. This is not consistent with "least-cost decisionmaking" and could result in higher rates.

48. Responding to concerns that an EWG owner might "walk away from the deal" after the debt is retired, LCG/Champion

contend that there is no histor cal or rational basis for the concern. If a utility is worried about it, a "buy-out provision" in the contract can be negotiated. With respect to EWG capital structure and reliability, LCG/Champion recommend that the Commission "apply the same principles in determining the prudence of long-term power purchase agreements as are applied in the case of utility-owned generation capacity."

Preapproval

49. LCG/Champion challenge the recommendation that the Commission preapprove power purchase agreements. They argue that 1) preapproval is not necessary to reduce the risk of purchased power because purchased power is not more risky than utility generated power, 2) preapproval invites the Commission to micro-manage utilities, 3) insight about the Commission can be gained from reviewing past Commission actions. LCG/Champion also counter MDU's suggestion that preapproval be incorporated into the least cost planning (LCP) process. They contend this would complicate the LCP process and is not consistent with the Commission's LCP guidelines. LCG/Champion summarize their position on the preapproval issue as follows: "The Commission should reserve judgment about the prudence of long-term power purchase agreements until such time as the utility seeks recovery of the cost associated with such agreements in a general rate case."

Fuel Supply

50. LCG/Champion oppose MPC's suggestion that a preapproval process should include an assurance of EWG fuel supply. They first note their opposition to preapproval generally, and they argue in addition that if assurance of fuel supply adequacy is required prior to approval of power purchases, the same assurance should be required for utility-owned or operated resources. LCG/Champion conclude that the Commission should not require such assurances in either case, because 1) assuring fuel supply is a management responsibility, and 2) fuel supply is one of many factors that must be considered in the planning process.

DISCUSSION

51. The Commission has carefully evaluated the evidence in this case to determine whether it should take any action -- apart from the usual rate case proceedings -- in response to the purchase of long-term power by jurisdictional utilities. The Commission concludes that, while the possibility of increased purchased power raises important issues relative to traditional utility operations, there are no compelling reasons why those issues should not be addressed on a case-by-case, utility specific basis.

Cost of Capital

52. Despite the arguments of MPC and MDU, the Commission does not find that the phenomenon of increased purchased power

should cause any change in the traditional regulatory treatment of cost of capital. The traditional proceeding for assessing utility costs, including the cost of capital, is a general rate case. If purchased power affects capital costs, then that will be considered in a rate case and factored into the cost of capital decision.

53. Least cost resource planning in Montana is a process whereby utilities compare the total societal cost of potential resources. The cost of capital is a cost within the universe of societal cost that utilities must account for in making resource choices. If purchased power increases the cost of capital then that increase must be netted against the cost advantages of the purchased power. Some increment of purchased power may represent the least societal cost, even though it increases the cost of capital. Weighing the costs and benefits of potential resources is the purpose of integrated resource planning and is a management responsibility.

54. MPC contends that the risk of purchased power is not reflected in rates. The Commission is not aware that it has specifically considered the risk of purchased power in setting MPC's rates, nor, having done so, refused to reflect such risk in rates. Currently, MPC purchases a portion of its power under long term contract. MPC's argument requires a reference to a case in which the Commission has refused, against the weight of the evidence, to reflect the risk of these purchases in rates. The Commission knows of no such case.

55. MPC's real concern appears not to be that regulation has not reflected purchased power risk, but that it will not reflect it. The Commission knows of no basis for this speculation. Utilities should purchase long term power if that is the least cost alternative, and they should argue the appropriate ratemaking consequences in general rate cases.

Capital Structure

56. Purchased power or no purchased power, the obligation to provide adequate and reliable service at the lowest cost remains with the utilities. Therefore, every utility resource decision must balance reliability and cost. The Commission agrees with LCG/Champion that "unfair advantage" is an inappropriate characterization of a situation in which an EWG is able to produce at lower cost than a utility, whether the lower cost results from capital structure or other legitimate reason. Lower power costs are desirable if they reflect total societal costs, which include the net effects of any change in reliability. Additionally, the Commission cannot find from this record that EWG capital structures that contain proportionally greater amounts of debt threaten reliability. If a utility has legitimate reasons for concern about EWG reliability, then it should either protect itself and its customers through the power purchase contract or it should acquire another resource. The Commission finds that whatever differences in capital structure, cost and reliability exist between EWGs and utilities, these

differences are simply factors that need to be considered by utilities in making resource decisions.

Preapproval/Fuel Supply

57. On this record the Commission can find no compelling reason to preapprove long-term purchased power contracts. Consequently, the question of whether to require fuel supply adequacy as a condition to preapproval is moot. Preapproving utility decisions is a way of shifting risk from utility shareholders to ratepayers. Utilities argue that preapproval benefits ratepayers because it reduces utility risk and lowers the cost of capital. Preapproval also, however, exposes ratepayers to the costs of unwise utility decisions. On balance, the Commission continues to find that ratepayers are better off by leaving the risk of decision with the utilities. The Commission can find nothing in the nature of purchase power decisions that causes it to change its general position on preapproval.

CONCLUSIONS OF LAW

1. The Commission has jurisdiction to regulate the rates and service of certain electric utilities. Section 69-3-101 et seq., MCA.

2. The Commission is required by the Energy Policy Act of 1992 to consider whether it is appropriate to implement certain standards for its jurisdictional electric utilities that may

purchase long-term wholesale power to meet demand. 16 U.S.C.A. §2621(10)(E).

3. The Commission has properly noticed a hearing in this Docket, and has properly noticed an opportunity to submit evidence and argument on the issues to be decided.

ORDER

NOW THEREFORE IT IS ORDERED that the Commission will not adopt special standards or rules pertaining to the purchase of long-term wholesale power by jurisdictional electric utilities. The Commission will consider the consequences of long-term purchased power on a case-by-case, utility specific basis.

Done and Dated this 11th day of July, 1994 by a vote of 5-0.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

BOB ANDERSON, Chairman

BOB ROWE, Vice Chairman
(Concurring Opinion Attached)

DAVE FISHER, Commissioner

NANCY MCCAFFREE, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Ann Purcell
Acting Commission Secretary

(SEAL)

NOTE: Any interested party may request the Commission to reconsider this decision. A motion to reconsider must be filed within ten (10) days. See ARM 38.2.4806.

OPINION OF COMMISSIONER ROWE

FINAL ORDER NO. 5701b, DOCKET NO. 93.3.10

This opinion discusses two topics. First, it offers some additional remarks on the inappropriateness of adopting specific policies at this time concerning the four Section 712 issues. Second, it raises a set of questions related to natural gas availability and use, which I hope will be addressed as the Commission continues it's Energy Policy Act-related work. Our goal in this process should be to use the EPAct as an aid in further developing approaches most appropriate to Montana and the region.

I. EPACT SECTION 712.

The Energy Policy Act is one accelerant in a combustible energy world. Closer to home, formalization of the Westwide Regional Transmission Group, promulgation of a specific proposal for electric industry restructuring by the California Public Utilities Commission and a much more clearly defined three-part proposal for the "reinvention" of the Bonneville Power Administration have all occurred since parties filed their comments in this proceeding last year.

These developments simultaneously confirm the wisdom of not acting prematurely and the foolishness of ignoring changes occurring around us. Relatively low embedded costs, a reasonable relationship between average and marginal costs, and the region's success in developing sound new resources such as demand-side management allow us to observe developments elsewhere and learn from others' experience. However, we must be prepared to help

shape changes which will occur. Recognizing this, Washington state expects to intervene in the California electric restructuring docket.

The standards we are now considering under Section 712 should be adopted only if they are consistent with the purposes of PURPA Title I.[1] It has been suggested that, for example, whether an exempt wholesale generator's probable capital structure provides it an "unfair advantage" against electric utilities is unrelated to any of the PURPA standards.[2] Experience has demonstrated the benefits of a certain amount of flexibility in achieving conservation, efficiency, and equitable rates. To that extent, adopting specific policies as part of our Section 712 inquiry could be counterproductive to the PURPA purposes.

Although the Commission is not adopting new policies in this proceeding, the parties' efforts in addressing the first set of Energy Policy Act issues is valuable. The Commission has learned much, and has identified the fora in which specific decisions might eventually be made.

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[1] Those purposes, specified in PURPA section 101, are: 1. Conservation by electric utilities; 2. more efficient use of facilities and resources by electric utilities; 3. equitable rates to electric consumers.

[2] Robert E. Burns and Mark Eifert, A White Paper on the Energy Policy Act of 1992: An Overview for State Commissions of New PURPA Statutory Standards (Columbus, Ohio: National Regulatory Research Institute, 1993).

II. NATURAL GAS SUPPLY AND USE.

A set of issues not adequately raised by our present consideration of "assurances of fuel supply adequacy" concerns future availability of natural gas supplies.[3] The following paragraphs are intended to raise some of these issues. Perhaps they may be more fully addressed in consideration of gas integrated resource planning.

Clearly, combined cycle combustion turbines will be part of the region's energy future. However, there are real risks created through over-reliance on any one resource option. This problem must be addressed on a regional as well as state and utility basis.

In the 1970's the region's energy leadership embraced the Hydro-Thermal Plan for massive nuclear development, driven by summing individual utility projections for ever-increasing demand. That led both to the WPPSS disaster and to passage of the Northwest Power Act. Similarly, individual utilities and independent power producers now emphasize natural gas generated electricity. Decisions which are rational on an individual utility basis could again combine to produce unsound regional

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[3] Inquiry (iv) concerns "whether to require as a condition for the approval of the purchase of power that there be reasonable assurances of fuel supply adequacy." For gas utilities, EPAct amends PURPA sections 302 and 303 by adding new standards concerning integrated resource planning and regulatory incentives for the encouragement of conservation and demand-side management. The gas IRP inquiry should occur this year.

results. (Over-emphasis on CTs could cause a low-grade WPPSS infection.)

Among the questions which should be answered by the region:

1. Are natural gas transmission systems adequate to supply projected combustion turbine demand?
2. Are natural gas supplies (primarily Canadian supplies) and price projections adequate and reliable? What will be the combined effect of CT development on supply and price? What other factors may affect supply and price, such as changes in Canadian environmental and other policies?
3. Where is it more appropriate to expand the natural gas distribution network for direct consumption rather than for electric production?
4. To what extent does the region's current success with electricity planning and demand-side management distort end use choices between electricity and natural gas?
5. What is the best use of the natural gas which is available? This is the core question.

These issues are directly related to but outside the scope of the present inquiry. They are outside the Commission's exclusive jurisdiction. However, it is essential that the Commission and stakeholders address them.

Strategies may include adopting natural gas and eventually all resource integrated resource plan rules; supporting regional

reform and coordination of siting decisions[4]; working through the Northwest Power Planning Council or other entities, first to track individual utility and independent power producer resource decisions, and then to ensure those decisions are made within a framework which is rational from a regional perspective. As resources permit, the Montana Public Service Commission should be an active participant on all fronts. WPPSS continues to demonstrate that regionally irrational results do come back around to bite the utility ratepayers who end up bearing the cost.

RESPECTFULLY SUBMITTED this 14th day of July, 1994.

BOB ROWE
Vice Chair

[4] Montana's relatively sound siting procedure may be undermined by decisions made in Washington or Idaho, and even Montana's statute probably needs modification.